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INFO RHEBAAA/DEPARTMENT OF ENERGY WASHDC
RUCPDOG/DEPT OF COMMERCE WASHDC
RUCNCIS/CIS COLLECTIVE
RUEHZG/NATO EU COLLECTIVE

UNCLAS SECTION 01 OF 03 KYIV 002844

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E.O. 12958: N/A

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SUBJECT: UKRAINE: KREMENCHUK OIL REFINERY CRISIS REMAINS UNRESOLVED

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11. (U) Summary. A longstanding, complicated legal dispute over the ownership of shares in Ukratnafta, a company established in 1994 that owns and operates Ukraine's largest oil refinery in Kremenchuk, recently culminated in the physical enforcement by police on October 19 of a Sumy Court of Appeals order that authorized the replacement of its CEO, Serhiy Hlushko, by former Ukratnafta Head Pavlo Ovcharenko. Tatarstan shareholders responded by shutting off oil supplies to the refinery. The Tatarstan and Russian governments characterized the takeover as commercial "raider activity," and called for immediate Ukrainian intervention to return Hlushko as CEO of the refinery. Some Ukrainian officials have noted that the Kremenchuk refinery produces a third of all gasoline and petroleum products for domestic consumption and predict negative economic repercussions if the situation remains unresolved much longer. The Ukrainian Ministry of Fuel and Energy, however, hopes for a compromise solution, but so far Tatarstan is not obliging. End Summary.

New CEO Alleges Malfeasance

12. (SBU) Ovcharenko was head of Ukratnafta from early 2003 until the Ukratnafta supervisory board dismissed him in November 2004. He subsequently appealed his dismissal in the courts, eventually winning in Sumy on August 29, 2007. Ovcharenko then used this order to re-install himself forcibly in the company's offices with Ukrainian police on October 19. Press reports have speculated that the timing of the takeover by Ovcharenko, who is considered loyal to Ukrainian shareholders, including the Pryvat Group of Ihor Kolomoisky, was related to the presumed pending naming of Yulia Tymoshenko as Prime Minister, as Kolomoisky in the past backed Tymoshenko. In private, Tymoshenko's camp has hotly denied any connection, maintaining that Kolomoisky no longer is providing support to her party. According to the Ukrainian press, Ovcharenko sent a letter to Ukrainian government officials accusing Hlushko of intentionally running up debts to Tatar shareholders and moving the company towards bankruptcy to increase their stake. The letter reportedly accuses Ukrainian Deputy Prime Minister Andriy Klyuyev of complicity in the scheme. Similarly, Ministry of Fuels and Energy officials told Econ Counselor that Hlushko was using tolling schemes in refining to shift profits from Ukratnafta.

Tatars Halt Oil Supplies to Refinery

13. (U) Outraged by Ovcharenko's takeover, the government of Tatarstan, which owns about a 37 percent stake in Ukratnafta ordered Tatneft, the company that supplies oil to the refinery, to suspend supplies on October 19th. Tatarstan government officials

stated publicly that supplies would be resumed if Hlushko is reinstated as CEO. The government of Tatarstan controls its large stake in Ukrtatnafta through Tatneft (8.613 percent) and the Tatarstan Property and Land Resources Ministry (28.778 percent). Ovcharenko, however, on the same day said that the refinery had existing stocks of crude oil (200,000 tons) sufficient for production at a lower capacity for 12 days. With current production reduced by more than half, according to a Tatneft official, the losses amount to \$4-5 million a day. Ovcharenko publicly claimed that Kremenchuk Oil Refinery would receive oil from Ukrainian and unnamed suppliers to ensure supplies for November. So far, energy experts expect Tatneft's suspension of oil supplies to the Kremenchuk refinery to affect Ukraine's domestic fuel market only moderately, suggesting that imports of refined products from neighboring countries could fill the gap in the short-term.

Tatars Used Shell Companies to Control Refinery? -----

¶4. (SBU) For more than seven years, controversy has surrounded two of Ukrtatnafta's shareholders that are rumored to be controlled by Tatarstan, allowing the Tatars de facto control of the refinery. One of the companies, Amruz Trading AG (Switzerland), owned an 8.336 percent stake in Ukrtatnafta, while the other, SeaGroup International PLC (USA), reportedly owns a 9.96 percent stake. Ukrainians in favor of greater Ukrainian control of the refinery have asserted that the combined shares owned by Tatneft, the Tatarstan Property and Land Resources Ministry, Amruz, and SeaGroup allowed the government of Tatarstan to control a 55.687 percent stake in Ukrtatnafta. It has been alleged in the Ukrainian press that Amruz and SeaGroup, each of which was established with about USD 100,000 in capital, might exist only on paper. In June 1999, the companies promised to invest USD 65.85 million in Ukrtatnafta, or provide the crude oil equivalent, in exchange for the combined 18.3 percent stake. Ukrtatnafta reportedly only received about USD

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3 million.

Shell Companies' Shares Returned to State Last Summer -----

¶5. (SBU) The GOU, which before 2007 controlled only 43.054 percent of Ukrtatnafta, for years claimed the government of Tatarstan had illegally gained control of the Kremenchuk oil refinery through the Amruz and SeaGroup stake. In July, Ukraine's state-owned oil and gas company, Naftohaz Ukrainy, announced that the 18.3 percent stake controlled by Amruz and SeaGroup had been written off by the Ukrnaftohaz Financial Group and transferred to Naftohaz, giving Naftohaz a 61.346 percent stake in Ukrtatnafta and control of the Kremenchuk oil refinery. The shareholders from Tatarstan protested, disputing the legality of the transfer of the 18.3% stake, and have filed suit with a court to have the write-off declared illegal.

GOU Lacks Unified Response to Refinery Takeover -----

¶6. (U) The GOU has not provided a unified response to the crisis. Minister of Economy Kinakh, Deputy Prime Minister for Fuel and Energy Klyuyev, and First Deputy Prime Minister and Finance Minister Azarov commented on the debacle from the GOU side. On October 23, Kinakh announced that, given that the Kremenchuk refinery accounts for 40 to 45 percent of Ukraine's refined oil products, including gasoline, the destabilization of the refinery's operations could lead to shortages. On the same day, Klyuyev, who is rumored to be close to the Tatarstan side, characterized Ovcharenko's actions as a hostile takeover and said an investigation would be launched. Azarov said the takeover was a corporate hijacking and that the Ukrainian Fuel and Energy Ministry was in talks with representatives of Tatar shareholders to resolve the situation.

7.(U) According to the Ukrainian press, the Minister of Fuel and Energy (MFE), Yuriy Boyko, who is considered a rival of Klyuyev's in the energy sector, has been accused by Tatarstan of engineering the takeover. Boyko, a former head of Naftohaz and a former Ukrtatnafta

CEO, has called for a legal study of the matter. Earlier this year, Boyko indicated interest in returning the disputed 18% share of Ukratnafta to state ownership. In July, MFE made an attempt to replace the management of the refinery but was unable to do so due to the conflict among the shareholders.

The Russian Reaction

18. (U) There is no lack of clarity on the Russian perspective. Russian Minister of Industry and Energy Viktor Khristenko on October 23, said publicly that his ministry intends to support Tatneft in its dispute with Ukratnafta. According to Russian press reports, the Kremlin has called the incident an attempted seizure by raiders and has expressed concern about the threat to Russian business and government interests. The State Duma has also officially condemned the seizure. The Russian press indicates that the Russian Foreign Ministry, on its website, has warned that illegitimate moves with Russian investors in Ukraine were damaging the investment climate and hindering deeper bilateral economic ties. The Foreign Ministry expressed hope that the situation will be quickly resolved in accordance with the law.

A Brokered Resolution Unlikely

9.(SBU) MFE has proposed talks with Tatarstan shareholders in an effort to resolve the crisis. In late October, the MFE proposed to convene an extraordinary meeting of Ukratnafta's Supervisory Board on October 31, but Tatarstan shareholders rejected the proposal, and also a proposed November 15 shareholders' meeting. A senior MFE official told Econ Counselor November 2 that the GOU would prefer a compromise solution. They would propose replacing Ovcharenko and Hlushko with a neutral figure acceptable to all sides. According to press reports, the Tatarstan shareholders anticipate filing lawsuits against the takeover soon. With that prospect, as well as the ongoing lawsuit regarding the transfer of the 18% stake, it appears that lengthy court wrangles are almost a given in this case.

10. (SBU) Comment: This latest dispute is perhaps a classic illustration of the tense relationship between Ukraine and Russia in the energy sector, as well as of the lack of transparency and murky corporate governance that characterizes the energy sector. As both sides seem intent on pursuing zero sum solutions, there seems little chance of a near-term resolution. It also does not help that the GOU itself seems far from unified in its approach to the takeover. For the time being, Ovcharenko seems to be able to obtain crude

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supplies, but given the refinery's role in the domestic refined product market, any disruption in supply poses a risk of gasoline supply disruptions throughout Ukraine at some point.
TAYLOR